No. 13,097

IN THE

United States Court of Appeals

For the Ninth Circuit

CHARLES A. CRISPIN and ALMA B. CRISPIN,
Appellants,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court for the Northern District of California, Southern Division.

APPELLANTS' REPLY BRIEF.

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Subject Index

Table of Authorities Cited

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ARGUMENT.

I. THE RECENT DECISION IN ELLIOTT C. MORSE (Jan. 28, 1952), 17 T.C. NO. 150.

After our reply brief was in draft form, we received the advance sheets of the opinion of the Tax Court in *Elliott C. Morse,* 17 T.C. No. 150, CCH Dec. 18,759, promulgated January 28, 1952. Had this case been decided before appellee's brief was printed, doubtless some of the statements in that brief would never have been made. For example, of our contention that appellant's annuity contract was income in 1940, appellee made the following remarks: On page 13 of its brief, appellee calls that contention a "highly theo-

retical argument", and notes that "no reported case has ever gone so far and to our knowledge the Commissioner has never asserted such a position."

In the *Morse* case the Commissioner did assert the same position we assert, and the Tax Court upheld him. In due course the Department of Justice will doubtless be called on to argue in support of that decision, and hence of the same position it now calls "highly theoretical."

In the *Morse* case, a taxpayer's employer purchased a single premium annuity contract for him in 1941. The employer remained the owner of the contract until 1943, when the taxpayer retired and the employer assigned ownership of the contract to him. His rights were not assignable, there being a spendthrift clause. The Commissioner assessed an income tax against him for 1943, on the theory the employer's cost of the contract was income to the employee in the year he became owner of the contract. The Tax Court, in an opinion reviewed by the entire Court, upheld the Commissioner's determination.

The opinion of the Court states that under "the principles laid down in *Renton K. Brodie,* supra, and the cases which have followed it * * * petitioner was taxable in 1943 because of the transfer of the policy to him in that year." The Court saw no difficulty in the fact that the payment for the contract had been made in a prior year, since it was the accession to ownership, not the fact of payment, which was the taxable event.

There was an additional obstacle to approval of the Commissioner's determination in the *Morse* case, in that the accession to ownership occurred after the enactment of the 1942 amendments to Section 22(b)(2), Section 23(p), and Section 165. We are not faced with that obstacle in this case. The Court held Section 22(b)(2)(B) inapplicable, a result contrary to the assumption which is basic to appellee's argument that Section 22(b)(2)(B) has something to do with the instant case. Since we have disposed of this contention of appellee on other grounds, infra, we need not discuss in detail this additional point in the *Morse* case.

The dissents in the *Morse* case were signed by five of the sixteen judges of the Tax Court. The first dissent was to the Court's interpretation of the 1942 amendments, as well as to the view that a nonassignable contract can be income. The second dissent would overrule *Brodie,* 1 T.C. 275. Both dissents neglect to refer to the numerous Court of Appeals decisions which would have to be overruled if their views were to be adopted.

It is evident that this timely clarification of the Tax Court's views on our basic point strongly supports appellant's position.

II. THE STATUTE DOES NOT CONFINE COST TO THOSE CONTRIBUTIONS ON WHICH A TAX HAS BEEN PAID.

The essential thread of appellee's argument, visible time and again throughout the brief, is that the cost of an annuity contract is a permissible deduction from the annuity receipts only to the extent necessary to prevent double taxation. If this argument is not sound, appellee has offered nothing to support the judgment.

If a recoverable cost is recognized only to the extent necessary to avoid double taxation, why has appellant any recoverable cost at all? His own contributions to the cost were paid from his salary, and he was not taxable on his salary. Therefore, he could be taxed presently on the full amount of the annuity receipts without there being double taxation. Yet the parties are in agreement that the contributions appellant made to the cost are recognizable cost, deductible from the taxable receipts. See footnote p. 7 of appellee's brief, where this concession is made, though understandably not highlighted.

Again, if cost is to be recognized only to the extent necessary to avoid double taxation, why is a donee of an annuity contract allowed any cost to be recovered tax-free? A gift is not subject to income tax, and may not be subject even to a gift tax. A gift larger than the total cost of appellant's annuity contract can be made tax-free by a single person, and one twice as large by a married person. Therefore the possibility of the gift not having been taxed at all is

anything but remote. Yet it is recognized that the donee's cost basis of an annuity contract includes his donor's contributions. *MacArthur v. Commissioner* (1948, CA 8), 168 F. (2d) 413; *Title Guarantee & Trust Co.* (1939), 40 BTA 475, 482.

The truth is that avoidance of double taxation is not the universal touchstone under Section 22(b)(2)(A), any more than it is under the related basis provisions applicable to depreciation and gains and loss on sales and exchanges.[1] We are certain neither appellee nor any Court would have any doubt that if appellant's employer had paid him a block of stock on his retirement in 1940, the cost basis of that stock would be its value on the date of receipt by appellant. If appellant later sold the stock, he would be taxable only on the excess of the sale price over that basis, i.e., on the increment in his hands after he got it. Yet the effect would be to exempt forever, not merely to prevent double taxation on, the value when appellant received it free of tax. Compare *Brown Shoe Co. v. Commissioner* (1950), 339 U.S. 583, where the basis of depreciation of corporate property was held to include values contributed by non-shareholders and on the receipt of which no tax had been paid.

Appellee's construction of the statute puts the cart before the horse. It proceeds as if the terms of the statute expressly stated that the recoverable cost of the annuity contract was only the "contributions of

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[1]I.R.C. Secs. 111, 113. Appellee also considers the problems under these sections to be related to that herein. Appellee's Brief, p. 10.

the annuitant," and the Courts had grafted an exception on that language to prevent double taxation. The language of the statute, however, is not so limited. In terms, it allows the tax-free recovery of *all* contributions. To prevent unjustified exemption of income which Congress had given no evidence of a purpose to exempt, the Courts have read the purpose of the provision into the statute. The purpose was to allow the tax free recovery of what had become capital. It does not follow from this that all contributions except those from taxed income can be ignored. The recognition accorded the contributions from appellant's untaxed salary, the recognition accorded contributions by way of gift, the recognition that would doubtless be accorded contributions from inherited capital—all these serve to emphasize the point.

There is not, nor has there been, any Congressional purpose to tax appellant's earnings received while he was a nonresident. Instead, the declared purpose is the exact opposite. I.R.C. Sec. 116(a). If, then, the receipt of this annuity contract was income to appellant while he was a nonresident, Congress' purpose was to exempt it, not to tax it.

We believe we demonstrated in our opening brief that under established concepts appellant received income in 1940 when in that year he became unconditional owner of the annuity contract. Appellee has been pleased to call our argument a "highly theoretical" one, and has disputed it without explaining why. Yet, in view of the position successfully adopted by the

Commissioner of Internal Revenue in the *Morse* case, supra, it must be apparent that appellee's position in the instant case does not reflect a considered, consistent policy of the Bureau of Internal Revenue.

III. THE IMPLICATIONS OF THE WOLFE CASE SUPPORT APPELLANT RATHER THAN APPELLEE.

Appellee's brief (pp. 7-8, 11-12) cites *Wolfe v. Commissioner,* 8 T.C. 689, 700-701, aff'd per curiam (CA 9), 170 F. (2d) 73, cert. den. 336 U.S. 914, and speaks of it as a case which interpreted Section 22(b)(2)(A). We can understand appellee's anxiety to find a decision from this Court which supported its position, but we do not believe that that anxiety has produced such a case. As we pointed out in our opening brief (App. Op. Br. p. 14), the *Wolfe* case did not involve an annuity contract but an apparently revocable promise of the employer. The Tax Court decided the case on this ground and expressly rejected the contention that an annuity contract was involved, so as to require construction of Section 22(b)(2)(A).[2]

Appellee, however, insists there was an alternate ground of decision beneficial to its cause. This is demonstrably contrary to the fact, as consideration of all the paragraphs on the pages cited by appellee (8 T.C. pp. 700-701), instead of only two of them,

[2]Since this Court wrote no opinion in the case, we infer it considered the matter adequately dealt with in the opinion of the Tax Court. For this reason we refer at some length to the opinion of that Court.

will reveal. The first paragraph ending on those pages discusses the facts of that case and concludes as follows:

> "We can not say, on all such evidence, that Anglo purchased an annuity from Standard."

Thus the Court rejected the contention that the case involved an annuity contract.

The next paragraph is as follows:

> "We conclude and hold that the moneys received by the petitioner in the taxable year were not 'Amounts received as an annuity under an annuity * * * contract,' within the language of that section. Nor is the contract made in 1940 otherwise shown to have been a contract taxable to the petitioner in 1940 (though not reported by him as Federal income or to Canada or England.)"

The first sentence of this paragraph is the statement of the legal conclusion which followed from the prior factual conclusion; namely, that Section 22(b)(2)(A) was not involved.

Presumably appellee reads the next sentence in the opinion as being an alternative ground of decision, but it is not: it is the commencement of the rejection of an additional argument advanced by the taxpayer. The opinion makes it quite evident that the taxpayer had argued an additional point, to the effect that even if the contract was not an annuity contract it was nevertheless a contract, and it had become income to him in 1940 while he was an exempt nonresident. This

argument was rejected, and had it not been rejected the taxpayer would have won regardless of the decision against him on the first issue.

The last three paragraphs of the opinion, not merely the first two of the last three, state the grounds for the rejection of this additional argument. It is quite evident the Tax Court did not take the simple course appellee says it did. It did not hold that a person who was an exempt nonresident when he acquired a pension contract would necessarily be taxable on its fruits when he received them because he had been exempt from tax when he received the contract. The Court could have said this easily had it intended to say it at all.

Instead the Court wrote three paragraphs showing that the particular contract by its very nature was not of a type to constitute income on its receipt. The first of these three paragraphs brings out the prior Tax Court authority for the proposition that the taxpayer's position depends on his ability to show that the contract he received in 1940 constituted "taxable income" to him in that year. The next paragraph constitutes a statement of that conclusion, concluding with these words (8 T.C. at 701):

> "So, if the petitioner had not 'taxable income' in 1940 in the 'annuity' funds, he had nothing to recover tax-free later."

If that case were to support appellee, it is at this point that the opinion should have said that since taxpayer was an exempt nonresident when he re-

ceived the contract, he could not have had "taxable income" on its receipt. It said nothing like this, however. Instead it embarked on a discussion of whether the nature of the receipt brought it within the concept of "taxable income" which has been evolved in the cases.

Confining itself to a consideration of the most closely analogous cases, those involving annuity contracts, it said:

> "In our opinion, this is not the class of contract taxable at value to the recipient. The contracts in (citations omitted; they are annuity contracts cases cited at pp. 12-13 of Appellants' Opening Brief), cited by the petitioner, and all cases found by us following them, were all ordinary commercial annuity contracts, purchased by employers from insurance companies for employees; therefore, the fact that they were held taxable to the recipients is no indication that an agreement here by Anglo and Standard to carry out their pension policy should be considered to have such value as to be taxable to the petitioner as recipient, and therefore offer reason to allow exemption from tax of amounts received in later years under the contract."

The clear implication of this language is that if the taxpayer had received a standard form annuity contract his case would have been different.[3]

Appellant herein did receive a standard form annuity contract, so his case is different from *Wolfe's*

[3]The recent *Morse* decision, supra, dispels any doubt which might exist that this is the intended implication of the quoted language.

case. If that *Wolfe* opinion had been from this Court instead of the Tax Court, the favorable implications of the foregoing language would have been strong authority for us, on which we would have relied. Since, however, that favorable implication might be deemed to be in the nature of dictum, we placed our case on the solid ground of principle. However, since appellee has chosen to lay great emphasis on the *Wolfe* case, we believe it is now proper for us to point out that the clear implication of the opinion is distinctly favorable to appellant.

IV. THE 1942 AMENDMENTS HAVE NO APPLICATION TO THIS CASE.

Appellee suggests (Br. 13-14, footnote) that the rule for which we contend is contrary to the 1942 amendents to Section 22(b)(2)(B). Notwithstanding appellee's unsupported denial, we take it to be entirely clear from the considerations set forth at page 5 of our opening brief that those amendments are without application to an annuity contract which had vested prior to 1942. This, however, does not appear to be appellee's real point. Its real point seems to be twofold: that the rule we argue for would be inequitable and impractical; and that the rule established by the 1942 amendments is merely declaratory of the old law.

The first point we need not challenge, since we do not concede the implication appellee would draw from

it. So far as inequity and impracticality are concerned, no distinction can be drawn between taxing a person on a single premium annuity and on an installment premium annuity. Neither one is cash, and in some of the decided cases the single premium annuity contracts were not even freely convertible into cash. Yet the inequity and impracticality of requiring an income tax to be paid in excess of the taxpayer's cash income for the year did not deter the Government from throwing single premium annuity contracts into income of the year of receipt, did not deter the Department of Justice from arguing to support such action, and did not deter the Courts from approving it. In *Hackett v. Commissioner* (1946, C.A. 1), 159 F. (2d) 121, referred to approvingly in appellee's brief no less than five times, the annuity cost taxed to one taxpayer in a single year was $75,000. Does anyone suppose that taxpayer was any happier about the result, or had any more ease in paying the tax, than he would have had if the $75,000 cost of the annuity contract had been paid by the employer in installments instead of one lump sum? Yet these considerations did not alter the result in the *Hackett* case, for as the Court there stated (159 F. (2d) at 123):

> "* * * the receipt of the annuity contracts constituted an economic benefit conferred as additional compensation which is the equivalent of cash."

Appellee's contention that our position is contrary to the 1942 amendments refers to the last sentence of Section 22(b)(2)(B). That sentence states a two-pronged

rule: *first,* it declares the circumstances in which an employee is taxable on his employer's contributions, in the case of a non-qualifying plan; *second,* it establishes a rule consistent with the first one for determining the tax-free cost of such an annuity. We do not see how it can be seriously suggested that the second prong of the rule can be applicable to annuities which had vested before the 1942 amendments were enacted, unless the first prong is also so applicable. Yet, as we have shown and appellee has conceded (Brief, footnote, p. 13), the amendments were all applicable to taxable years commencing after December 31, 1941. Therefore neither prong of the rule is directly applicable to this case.

Appellee then is driven to contend that the 1942 amendments were merely declaratory of existing law. Of course, it is obvious that as to most of the 1942 amendments to Section 22(b)(2)(B), Section 23(p), and Section 165, this is not true at all. In 1942 the sketchy and primitive treatment of employee's retirement plans was given a thorough goingover, and a new, complete and carefully integrated system was worked out. While some parts of the existing framework of law were utilized, this was done not because of any purpose to restate existing law but because certain fragments of it were good enough to retain in the new structure.

Hackett v. Commissioner (1946, C.A. 1), 159 F. (2d) 121, 125, in this connection is authority that the idea that the employer's contributions were part of

the allowable cost was not new in Section 22(b)(2)(B). We believe that is correct. The case recognizes expressly that the 1942 amendments were part of a careful scheme designed to improve on preexisting law. The whole point of the *Hackett* case, in this connection, is that the Court felt itself free to decide the case without any inferences drawn from the form of the 1942 amendments. We submit that this Court should feel equal freedom.[4]

No congressional purpose will be frustrated by appellant's position herein. Congress exempted him from tax on his earned income while he was a non-

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[4]The legislative history is as follows: The House bill in 1942 contained a provision taxing the employee, in nonqualifying plans, on all his employer's contributions, both past and present, in the year his rights became nonforfeitable. The committee report (H. Rep. 2333, 77th Cong., 2d Sess., p. 105; same, 1942-2 C.B. at 451) discloses this much but not what the House thought the prior law was. The Senate changed the provision to its present form, the Finance Committee reporting as follows:

> "The provision in the House bill to the effect that if the rights of the employee change from a forfeitable to a nonforfeitable right, under a plan which does not meet the requirements of section 162(a), the amount paid by the employer shall be included in income of the employee in the year in which the change occurs, has been stricken. Any amounts contributed by an employer for the benefit of an employee whose rights are forfeitable at the time of the contribution, will not be required to be included in the income of the employee until such amounts are actually received or made available to the employee." (S. Rep. 1631, 77th Cong., 2d Sess., p. 141; same, 1942-2 Cum. Bull. at p. 609.)

The conference report is silent on the point. H. Rep. 2586, 77th Cong., 2d Sess., pp. 52-53; same 1942-2 C.B. at pp. 713, 714.)

The Senate committee report has the sound of writing a new rule. If any relevant inferences can be drawn from it, they are that insofar as cases such as this one are concerned, the rules were changed in 1942. As we believe we have demonstrated, if the case is decided free of inferences drawn from the 1942 amendments, the result is the same.

resident.[5] If the same care to define income broadly is used in applying the Congressional purpose to exempt income of nonresidents as in applying the Congressional purpose to tax income of residents, there can be but one result here. The judgment will be reversed.

CONCLUSION.

The judgment should be reversed.

Dated, San Francisco, California,
February 8, 1952.

Respectfully submitted,
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[5] Appellee's reliance on estoppel cases, such as *Johnson v. Commissioner* (C.A. 5), 162 F. (2d) 844; *Commissioner v. Farren* (C.A. 10), 82 F. (2d) 141, and *Larkin v. U.S.* (C.A. 8), 78 F. (2d) 951, is a measure of desperation. Appellant is not estopped by having enjoyed an expressly conferred exemption.